Litigation Funding in Bankruptcy Cases

A New Frontier in Canada?

By Karen Fellowes

Litigation funding, or commercial litigation financing, is funding provided by third-parties to cover the costs associated with litigation. These third-parties are unrelated to the lawsuit and provide outside funding for the proposed action as a form of investment. For insolvent estates, this third-party funding may present opportunities to pursue legal action that otherwise would be deemed unaffordable. The aim of this litigation is to maximize the amount of money recoverable in an insolvent estate to the benefit of creditors and other stakeholders.

As some commentators have noted, "in most corporate bankruptcy cases, debtors' assets are typically 'liened up' well in advance of a bankruptcy filing, leaving little value unencumbered for anyone other than senior lenders." In this respect, litigation funding can provide financial assistance for estates that do not have adequate resources to pursue claims themselves. Common types of claims that are funded include breaches of directors' duties, reviewable transactions/fraudulent preferences, insolvent trading and actions against advisors or third-party defendants. Funding can also be used to continue actions that were ongoing at the time of the bankruptcy but were stayed as a result of the filing.

While litigation funding has become accepted practice in Australia and the United States, to date, Courts in Canada have been hesitant to endorse third-party funding. By taking a percentage of the award in successful cases, litigation funding allows companies to profit off the legal actions of others. This engages the old English legal doctrine of Champerty and Maintenance, ie. the intermeddling in litigation by a disinterested party for an improper motive or the sharing of litigation profits. This doctrine generally characterized such actions as an abuse of the administration of justice.

Canadian Courts have recently begun to embrace the idea that third-party funding agreements are not necessarily prohibited, particularly in the context of class action litigation. Courts need to look at a balancing of interests. This balancing involves weighing the benefits of access to legal services against potential abuse of the justice system for profit. In *Berg v Canadian Hockey League*, 2016 ONSC 4466, a class action case, the court stated, "if agreements do not overreach or interfere with the lawyer-client relationship, the administration of justice, or some regulatory provision, then they are permissible and justified as a means to afford access to justice."

Another concern expressed is the level of influence and the protections that must be put in place to limit the influence that third-party funders may have over a lawsuit. Part of Canada's hesitancy to welcome litigation funding is rooted in concern regarding the influence third-party funders may exert over legal decisions involving counsel, settlements, case strategy, or the pursuit of potential claims. The funding industry is quite professional, however, and reputable funders will have terms in their funding agreement ensuring that the client controls the litigation. Proponents of litigation funding adhere to the view that litigation funding provides access to legal actions that would otherwise be unavailable. According to advocates of third-party funding, if the litigation is unsuccessful, the funder loses its investment and pays any costs ordered, leaving the borrower in no worse a position than when they started.

On March 16, 2018, the Superior Court of Quebec approved a debtor's request for litigation funding in the context of CCAA proceedings. Bluberi Gaming Technologies Inc. ("Bluberi") filed for creditor protection under the CCAA, and its only asset was a potential lawsuit against its largest secured creditor, estimated at a value of $200 million. As an insolvent company, Bluberi was unable to pursue its claim on its own, and entered into a funding agreement with Bentham IMF, a publicly-listed Australian company that opened Canadian operations in 2016. Among the reasons given by the court for its decision, Justice Michaud stated that litigation funding allows Bluberi access to justice, provides the funder with compensation that is fair and reasonable, and does not diminish Bluberi's ability to control its litigation or instruct its counsel. In addition, the court noted that third-party funding agreements are not

illegal, and that they should be approved subject to the following:

- the agreement must be necessary to provide the plaintiff with access to justice;
- the plaintiff's right to instruct and control the litigation should not be diminished by the agreement;
- the agreement does not compromise or impair the lawyer and client relationship or the lawyer's duties of loyalty and confidentiality;
- the compensation of the third-party funder is fair and reasonable; and
- 0the third-party funder undertakes to keep confidential any confidential or privileged information.

As a result of this case, Bentham is currently set to fund its first insolvency case in Canada. According to Bentham, "this decision represents an exciting development for the commercial litigation funding industry in Canada."

In April 2018, the court granted leave to appeal to Callidus Capital Corporation (the secured lender against whom Bluberi seeks to claim against) and another creditor appellant. Leave to appeal was granted based, in part, on the appellants' submission that litigation funding is comparable to an alternative plan of arrangement, and as such, it should be put to a vote by the creditors in the same respect that other plans of arrangement are required to be put to a vote under the *Companies' Creditors Arrangement Act,* RSC, 1985, c. C-36 (CCAA). This position contrasts the respondent's submission that litigation funding is not a plan of arrangement, but is rather, a realization of an asset. In addition, the appellants submit that they should be provided with an un-redacted version of the litigation funding agreement so that they can better evaluate the impact of the litigation financing charge and the allocation of the litigation proceeds, information that may in fact be protected under litigation privilege.

While third-party financing typically funds claims over $5 million, some funders also offer funding for small corporate and insolvency claims under $1 million where the estimated recovery is approximately 10 times the litigation budget. This funding can be used for lawyer and insolvency practitioner fees, legal fees, court ordered costs, and investigation costs. In addition, non-recourse preliminary funding between $20,000 - $50,000 may also be available to allow for initial investigations or to hire experts to help understand and identify potential claims. In exchange for the funding offered by third parties, funders contract for reimbursement of funds advanced and a return, if the claim is successful. These fees are calculated based on risk assessment and the likely duration of the action, and they are assessed as either a percentage of the award recovered or a multiple of the initial investment.

Without third-party financing, other options available to LITs may require the selling of property, bank loans and financing, or seeking representation from a contingency law firm. Contingency law firms often recover 40 per cent of the award in successful claims, which is usually much higher than the fees associated with litigation funding. Additionally, it may not always be possible for parties to receive financing from a traditional source, rendering third-party funding a viable option for pursuing claims in insolvency files.

Insolvency professionals will be watching the *Bluberi* case closely as an indicator of whether third party litigation funding will continue to gain traction in the Canadian market. RS

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